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No. 44

In the Supreme Court of the United States

OCTOBER TERM, 1941

THE UNITED STATES OF AMERICA, PETITIONER

v.

THE STATE OF TEXAS, ET AL.

ON WRIT OF CERTIORARI TO THE COURT OF CIVIL APPEALS FOR THE SECOND JUDICIAL DISTRICT OF TEXAS

BRIEF FOR THE UNITED STATES

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	2
Specification of errors to be urged	5
Summary of argument	6
Argument:	
The United States is entitled to priority except to the extent of the mortgagee's claim	7
Conclusion	14
Appendix	15

CITATIONS

Cases:	
Arnson v. *Murphy*, 109 U. S. 238	13
Brent v. *Bank of Washington*, 10 Pet. 596	8
Conard v. *Atlantic Insurance Co.*, 1 Pet. 386	8
Dollar Savings Bank v. *United States*, 19 Wall. 227	13
Ferris v. *Chic-Mint Gum Co.*, 14 Del. Ch. 232	12
Florida v. *Mellon*, 273 U. S. 12	13
McCulloch v. *Maryland*, 4 Wheat. 316	13
New York v. *Maclay*, 288 U. S. 290	6, 8, 9, 12, 13
Savings Society v. *Multnomah County*, 169 U. S. 421	8
Spokane County v. *United States*, 279 U. S. 80	9, 12, 13
State v. *Wynne*, 134 Tex. 455	4, 11
Thelusson v. *Smith*, 2 Wheat. 396	8
United States v. *Fisher*, 2 Cranch 358	12
United States v. *Knott*, 298 U. S. 544	10
United States v. *Snyder*, 149 U. S. 210	13
United States v. *Summerlin*, 310 U. S. 414	13
Statutes:	
Revenue Act of 1932, 47 Stat. 169:	
Sec. 617	15
Revised Statutes:	
Sec. 3186 (U. S. C., Title 26, Secs. 1560–1562)	16
Sec. 3466 (U. S. C., Title 31, Sec. 191)	15
Vernon's Texas Statutes (1936), Title 122:	
Chapter 2:	
Art. 7065a–2	17
Art. 7065a–7	17

Statutes—Continued.
Vernon's Texas Statutes—Continued.
Chapter 8: Page
Art. 7266 18
Art. 7272 18
Art. 7273 18
Art. 7274 19
Art. 7275 19
Miscellaneous:
Rogge, *Differences in the Priority of the United States in Bankruptcy and in Equity Receiverships* (1929), 43 Harv. L. Rev. 251, 275 12

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OPINIONS BELOW

The opinion of the Court of Civil Appeals for the Second Supreme Judicial District of Texas (R. 66) is reported in 138 S. W. (2d) 924. The opinion of the Supreme Court of Texas (R. 58) answering the certified questions is reported in 134 Tex. 476, 133 S. W. (2d) 963.

JURISDICTION

The judgment of the Court of Civil Appeals for the Second Supreme Judicial District of Texas was entered on March 15, 1940. (R. 65.) The appli-

cation by the United States for a writ of error was denied by the Supreme Court of Texas on October 2, 1940 (R. 82), and a motion for rehearing (R. 82) was overruled by the Supreme Court of Texas on October 30, 1940 (R. 83). On January 23, 1941, Mr. Justice Black extended the time within which the United States might file a petition for a writ of certiorari for a period of 60 days from January 30, 1941 (R. 84). Petition for a writ of certiorari was filed March 31, 1941, and was granted May 12, 1941.

The jurisdiction of this Court is invoked under Section 237 (b) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, under Section 3466 of the Revised Statutes, the claim of the United States against an insolvent person for gasoline taxes is entitled to priority in payment over the claim of the State of Texas for state gasoline taxes.

STATUTES INVOLVED

The applicable statutes are set out in the Appendix, *infra*, pp. 15–19.

STATEMENT

This case involves the competing claims of the United States, the State of Texas, and a chattel mortgagee against the assets of an insolvent debtor, W. L. Nix. The litigation was initiated on No-

vember 20, 1933, in the District Court of Gregg County, Texas, by a creditor's petition filed by one M. R. Ingram seeking the appointment of a receiver (R. 1–4). A receiver was appointed on the same day (R. 4).

Three interventions followed which furnish the basis for this controversy: one by R. P. Ash, a chattel mortgagee, seeking payment of the mortgage indebtedness (R. 5); a second by the State of Texas on account of state gasoline taxes (R. 9); and the third by the United States on account of federal gasoline taxes (R. 12). Thereafter, one Howard Dailey appeared as successor in interest to the mortgage claim of Ash (R. 15).

The facts, as determined by the trial court (R. 34–40), may be summarized as follows:

On November 20, 1933, and at all times thereafter, Nix was insolvent (R. 40, 58). Upon the sale of Nix's assets and payment of the costs of administration, the receiver turned into the custody of the court the total amount of $7,516.92 (R. 36, 40).

The Ash mortgage note was executed September 19, 1933, and was in the face amount of $4,651.86. The mortgage was duly recorded September 20, 1933, and no payments have been made thereon (R. 39–40). Of the amount turned into the custody of the court by the receiver, $1,294.80 thereof was allocable to the property covered by the mortgage (R. 38, 40).

The gasoline taxes due to the United States relate to the period May–November, 1933, and are in the amount of $19,343.91, including penalty (R. 36-37, 40, 41).

The taxes, interest, fines, and penalties sought by the State of Texas, are in the total amount of approximately $42,812.51 (R. 37, 40).

The trial court ruled that after the payment of $75 as additional compensation to the receiver (R. 38), the relative priorities were to be as follows: first, the claim of the mortgagee's successor in the amount of $1,294.80; second, the claim of the United States; and third, the claim of Texas (R. 38, 40–41). However, since the prior claims would exhaust the debtor's assets, nothing would be left to be applied to the claim of Texas.

The State thereupon sought review in the Court of Civil Appeals for the Second Supreme Judicial District of Texas, and the appellate court in turn sought instruction from the Supreme Court of Texas by means of certified questions (R. 41). The questions were answered by the Supreme Court of Texas in an opinion (R. 58) which relied largely upon an opinion in a companion case decided the same day (*State* v. *Wynne*, 134 Tex. 455), the effect of which was to declare, first that the Texas statute (Section 7 of Article 7065a of Vernon's Texas Civ. St.) giving Texas "a preferred lien, first and prior to any and all other existing liens" upon all the business property of a distributor of gasoline, is

valid under both the State and Federal Constitutions; and second, that the claim of Texas is prior to that of the United States, notwithstanding the provisions of Revised Statutes, Section 3466.

In accordance with the answers to the certified questions, the Court of Civil Appeals thereupon ruled that the proper classification of the respective claims was Texas, first, lienholders, second, and United States, third. (R. 71.) It noted, however, that nothing would remain beyond the amount paid over to Texas. (R. 71.) The United States filed a motion for rehearing (R. 72), which was overruled (R. 72). The United States then applied to the Supreme Court of Texas for a writ of error (R. 73), which was refused (R. 82), and a motion for rehearing thereafter filed October 15, 1940 (R. 82), was likewise overruled (R. 83).

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In granting priority in payment of the claim of the State of Texas over the claim of the United States.

2. In holding that the lien of the State of Texas, if any, was superior to the lien or prior rights of the United States.

3. In reversing the decision and judgment of the District Court of Gregg County, Texas, granting priority in payment of the claim of the United States over the claim of the State of Texas.

SUMMARY OF ARGUMENT

Under Section 3466 of the Revised Statutes the debts owing to the United States are entitled to priority over the debts owing to the state, notwithstanding the provisions of any state legislation purporting to give the state a general lien upon the insolvent debtor's property. *New York* v. *Maclay*, 288 U. S. 290. Accordingly, if this proceeding were simply a contest between the United States and Texas, the *Maclay* decision would plainly require that the Texas claim be subordinated to that of the United States.

The complication presented by the presence of a third creditor, a chattel mortgagee is due to the fact that under Section 3466, the United States recognizes his priority over that of the Federal Government, while under Texas law, his claim is inferior to that of the State. Thus the lower courts thought that they were faced with the dilemma of (1) either placing the mortgagee ahead of the United States and thereby defeating the local priority of the state (i. e., mortgagee, first, United States, second, and Texas, third), or (2) placing the State ahead of the mortgagee, with the result that the United States would be third, and thus lose the advantage intended by Section 3466. The Texas courts chose the second alternative.

We submit that the dilemma was not a true one. The correct solution is to set aside sufficient funds to meet the mortgagee's prior claim under Sec-

tion 3466, placing the United States second, but permitting the State to assert its local priority over the mortgagee with respect to the amount set aside. This solution gives effect to the rights of the United States under Section 3466, and at the same time subordinates the claim of the mortgagee to that of the State under local law. Any other solution based upon state law that would place the United States in a less advantageous position would of necessity render the state statute unconstitutional.

ARGUMENT

THE UNITED STATES IS ENTITLED TO PRIORITY EXCEPT TO THE EXTENT OF THE MORTGAGEE'S CLAIM

1. It may be helpful at the outset to indicate the precise nature of the federal statutory provisions involved. In seeking to enforce a tax liability as against the competing claims of other creditors, the United States generally relies upon either Section 3186 or Section 3466 of the Revised Statutes. See Appendix, *infra*, pp. 15–17. These sections, although superficially dealing with the same general problem, have independent spheres of operation. Section 3186 is a *lien* statute, whereas Section 3466 is merely a *priority* statute.

Under specified conditions, Section 3186 accords the United States a lien upon a taxpayer's property, and whether that lien is superior to the specific liens held by other creditors generally depends

upon which lien is prior in time. Section 3466, on the other hand, does not create any lien; it simply provides that in the case of an insolvent debtor the debts due to the United States (whether for taxes or otherwise) shall be paid first. In the absence of any outstanding mortgages, the United States prevails over all other creditors, and its rights are subordinate only to prior rights of mortgagees.[1]

This case arises under Section 3466, rather than under Section 3186. Accordingly, the rights of the United States depend, not upon any lien, but simply upon whatever priority is afforded by Section 3466. (The decisions below as well as a number of other decisions of lower courts often erroneously refer to Section 3466 as giving a "lien" to the United States.)

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[1] Although Section 3466 seems to require that all claims be subordinated to the federal claim, it has been judicially interpreted to allow priority to a mortgage creditor. *Conard* v. *Atlantic Insurance Co.*, 1 Pet. 386; *Brent* v. *Bank of Washington*, 10 Pet. 596, 611–612; *Savings Society* v. *Multnomah County*, 169 U. S. 421, 428. The theory of these decisions is that a mortgage is really a conveyance by the mortgagor which divests the mortgagor of title thereby leaving nothing but an equity to which the preference can attach. See *Thelusson* v. *Smith*, 2 Wheat. 396, 426. This exception to the general rule was unenthusiastically restated by Mr. Justice Cardozo in the *Maclay* case (288 U. S. at 293–294), and he indicated serious doubt whether that exception would apply where the mortgage was of the lien type which did not effect a conveyance of legal title. For the purpose of this case, however, we assume that the exception is sound and that the mortgage herein falls within the exception.

2. Accordingly, if there were no mortgage creditor in this case, and if the controversy were merely as between the United States and Texas, it is clear that Section 3466 would require priority to be accorded to the claims of the United States.[2] *Spokane County* v. *United States*, 279 U. S. 80; *New York* v. *Maclay*, 288 U. S. 290. And the mere fact that the state has attempted to give itself a general prior lien on the assets of the debtor would not change the result. *New York* v. *Maclay*, *supra*. Until the state's inchoate lien is perfected against specific property of the debtor, the state occupies the position of a general creditor for the purpose of Section 3466, and its claim is subordinate to that of the United States. The *Maclay* case so holds and we do not understand Texas to contend otherwise.

That the lien of the state is only an inchoate one is confirmed by the state's comprehensive system for the collection of delinquent taxes. Articles 7266, 7272 and 7275 of Chapter 8, Title 122, Vernon's Texas Statutes provide in detail for the seizure and sale of property to satisfy tax claims, and make it plain that it is necessary for the state to levy upon the property to defeat the priority of the United States. As this Court said in the *Maclay* case (288 U. S. at 293–294):

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[2] The decision of a Missouri Court of Appeals, that section 3466 has been modified by the Bankruptcy Act, is now before the Court and need not be discussed here. See *United States* v. *Emory*, No. 33, this Term.

> In what has been written there has been an assumption in favor of the petitioner that the tax would have priority if its amount had been liquidated before rights and interests became static through insolvency proceedings. The assumption is hardly to be reconciled with a judgment of this court pronounced a century and more ago. *Thelusson* v. *Smith*, 2 Wheat. 396, 426. The ruling there was that the general lien of a judgment upon the lands of an insolvent debtor is subordinate to the preference established by the statute unless seizure by a marshal or some other equivalent act has made the lien specific and brought about a change of title or possession. * * *

Thus, the so-called lien of the State of Texas is inchoate and "lacks the characteristics of a specific perfected lien which alone bars the priority of the United States." *United States* v. *Knott*, 298 U. S. 544, 551. And if further confirmation is needed that the Texas statute did not effect a transfer of title from the insolvent taxpayer it may be found in the fact that the receiver was permitted to take over all of the taxpayer's property and sell it under court order. If the state had perfected its lien by a prior levy the property would not have been a part of the insolvent's estate.

Therefore, if this case were simply a contest between the United States and Texas, the priority of the Federal Government's claim would not be open to question. But this case is complicated by

the fact that in addition to the claims of the United States and Texas, there is a claim of a chattel mortgagee. The United States recognized the prior claim of the mortgagee, and accordingly urged that, under Section 3466, the relative priorities should be: the mortgage creditor, first, the United States, second, and the State of Texas, third. The State, on the other hand, relying upon its own statutes insisted upon preceding the mortgagee. Thus, the courts below considered themselves faced with the dilemma of either placing Texas third under the scheme of Section 3466 and thereby depriving the state of its local priority over the mortgagee, or by placing Texas first, and thereby varying the priorities under Section 3466 to the disadvantage of the United States.[3]

We submit (a) that the dilemma is more apparent than real, for the relative priorities required by Section 3466 can be given effect, while at the same time recognizing the state's superiority over the mortgage creditor under local law; and (b) that, in any event, even if the scheme of priorities under Section 3466 were inconsistent with state law the latter would have to yield.

(a) The priorities required by Section 3466 can be given effect while at the same time subordinating

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[3] The opinion of the Supreme Court of Texas (R. 58–64) simply set forth the statement of facts and certified questions, and disposed of the case without discussion by referring to its recent opinion in *State* v. *Wynne*, 134 Tex. 455, where it had given extensive consideration to the issues involved.

the claim of the mortgagee to that of the state. The problem was recognized in *Spokane County* v. *United States, supra,* and the Court set forth without comment the solution suggested by the Government, namely, that the correct result could be achieved by "setting apart sufficient funds to pay the mortgage before paying the federal taxes and then providing for payment of the state tax out of the sum so set apart." 279 U. S. at 91.

We submit that such an allocation of the debtor's assets not only carries out the purpose of Congress, but also gives effect to the priority accorded to the state by its own legislature over the mortgagee. Thus the suggested solution fully recognizes the scheme of priorities established by the Texas legislature within the limits of Section 3466 and the *Maclay* and *Spokane County* decisions.[4]

(b) If the suggested solution cannot be adopted, and if the Texas statute varies the priorities so that the United States is placed in a less advantageous position than is accorded to it by Section 3466, we then submit that the state statute would have to give way. The supremacy of the federal priority over that of the states was recognized by the Court as early as 1805 in *United States* v. *Fisher,* 2 Cranch 358. There, in response to the attack upon the statutory provisions which later became Sec-

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[4] A seemingly contrary result in *Ferris* v. *Chic-Mint Gum Co.*, 14 Del. Ch. 232, has been adversely criticized in Rogge, *The Differences in the Priority of the United States in Bankruptcy and in Equity Receiverships* (1929), 43 Harv. L. Rev. 251, 275.

tion 3466, Chief Justice Marshall declared (pp. 395–396):

> This claim of priority on the part of the United States will, it has been said, interfere with the right of the state sovereignties, respecting the dignity of debts, and will defeat the measures they have a right to adopt, to secure themselves against delinquencies on the part of their own revenue officers. But this is an objection to the constitution itself. The mischief suggested, so far as it can really happen, is the necessary consequence of the supremacy of the laws of the United States on all subjects to which the legislative power of congress extends.

Cf. *Florida* v. *Mellon,* 273 U. S. 12, 18.

Similarly, in providing for collection of taxes through the enforcement of liens, Congress may legislate in complete disregard of state laws relating to the recording of mortgages or liens. *United States* v. *Snyder,* 149 U. S. 210. And it has become firmly established that it is beyond the power of a state legislature to enact laws that may retard or impede the operation of the revenue laws of the national government. *New York* v. *Maclay, supra; Spokane County* v. *United States, supra.* Cf. *McCulloch* v. *Maryland,* 4 Wheat. 316; *United States* v. *Summerlin,* 310 U. S. 414; *Dollar Savings Bank* v. *United States,* 19 Wall. 227; *Arnson* v. *Murphy,* 109 U. S. 238.

It is therefore quite apparent that if the Texas statute be applied so as to place the United States

in a position inferior to that otherwise required by Section 3466, the Texas statute would be invalid.

CONCLUSION

The judgment of the court below should be reversed.

Respectfully submitted.

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AUGUST, 1941.

APPENDIX

Revenue Act of 1932, 47 Stat. 169:

SEC. 617. TAX ON GASOLINE.

(a) There is hereby imposed on gasoline sold by the importer thereof or by a producer of gasoline, a tax of 1 cent a gallon, except that under regulations prescribed by the Commissioner with the approval of the Secretary the tax shall not apply in the case of sales to a producer of gasoline.

(b) If a producer or importer uses (otherwise than in the production of gasoline) gasoline sold to him free of tax, or produced or imported by him, such use shall for the purposes of this title be considered a sale.

(c) As used in this section—

(1) the term "producer" includes a refiner, compounder, or blender, and a dealer selling gasoline exclusively to producers of gasoline, as well as a producer.

(2) the term "gasoline" means gasoline, benzol, and any other liquid the chief use of which is as a fuel for the propulsion of motor vehicles, motorboats, or aeroplanes.

Revised Statutes:

SEC. 3466. Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well

to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed. (U. S. C., Title 31, Sec. 191.)

SEC. 3186 (as amended by the Revenue Act of 1928, 45 Stat. 791, Sec. 613). (a) If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person. Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time.

(b) Such lien shall not be valid as against any mortgagee, purchaser, or judgment creditor until notice thereof has been filed by the collector—

(1) in accordance with the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law provided for the filing of such notice; or

(2) in the office of the clerk of the United States District Court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law provided for the filing of such notice; or

(3) in the office of the clerk of the Supreme Court of the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

* * * * *

(U. S. C., Title 26, Secs. 1560–1562.)

Vernon's Texas Statutes (1936):

TITLE 122—TAXATION

CHAPTER 2.—TAXES BASED UPON GROSS RECEIPTS

* * * * *

ART. 7065a–2 *Occupation or excise tax; rate; reports by distributors to Comptroller.*—(a) There is hereby imposed an occupation or excise tax of four (4) cents on each gallon of motor fuel or fractional part thereof. * * *

* * * * *

ART. 7065a–7. *State's lien on property of distributor for taxes, fines, etc.*—All taxes, fines, penalties and interest due by any distributor to the State shall be a preferred lien, first and prior to any and all other existing liens, contract or statutory, legal or equitable, and regardless of the time such liens originated, upon all the property of any distributor, devoted to or used in his business as a distributor, which property shall include refinery, blending plants, storage tanks, warehouses, office buildings and equipment, tank trucks or other motor vehicles, stocks on hand of every kind and character whatsoever used or usable in such business, including crude oil or other materials for the manufacture, refining, blending or compounding of motor fuels and the refined products therefrom and the proceeds

from the sale of such materials and refined products, and any other property of every kind and character whatsoever and wherever situated devoted to such use, and each tract of land on which such refinery, blending plant, tanks or other property is located, or which is used in carrying on such business.

* * * * *

CHAPTER 8.—COLLECTION AND COLLECTOR

* * * * *

ART. 7266. *Forced collections to begin.*—If any person shall fail or refuse to pay the taxes imposed upon him or his property by law, until the first day of January next succeeding the return of the assessment roll of the county to the Comptroller, the tax collector shall, by virtue of his tax roll, seize and levy upon and sell so much personal property belonging to such person as may be sufficient to pay his taxes, together with all costs accruing thereon; * * *.

* * * * *

ART. 7272. *All property liable for taxes.*—All real and personal property held or owned by any person in this State shall be liable for all State and County Taxes due by the owner thereof, including tax on real estate, personal property and poll tax; and the Tax Collector shall levy on any personal or real property to be found in his county to satisfy all delinquent taxes, any law to the contrary notwithstanding; * * *.

ART. 7273. *Sales of personal property.*—In making sales of personal property for taxes, the collector shall give notice of the time and place of sale, together with a brief description of the property levied on and

to be sold, for at least ten days previous to the day of sale, by advertisements in writing to be posted at the courthouse door, and at two other public places in the county; and such sale shall take place at the courthouse door of the county in which the assessment is made, by public auction.

ART. 7274. *If property is insufficient.*—If personal property levied upon prove insufficient to satisfy the taxes and penalties due and costs accrued thereon, the collector shall levy upon and sell so much other personal taxable property belonging to the person as will be sufficient to satisfy such taxes, penalties and costs in the same manner as an original levy and sale, and, in all cases of sales for taxes, if there be an excess remaining in the hands of the collector, after satisfying all taxes, penalties and costs, the same shall be paid over to the original owner by the collector, or deposited in the hands of the county treasurer subject to the order of such owner.

ART. 7275. *Sales of real property.*—If the delinquent is not possessed of a sufficiency of personal property in the county subject to seizure and sale to satisfy all taxes due by him, the tax collector shall seize so much of the real estate of such delinquent, situated in the county, as will be sufficient to satisfy such taxes and all costs, and sell the same in accordance with the provisions of the succeeding article.

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